

Gunning for success – Hong Kong Court of Final Appeal rules on fees in financial introductions

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It is not uncommon for companies exploring expansion or other ways of raising capital to engage financial advisers to provide a range of consultancy services, including the introduction of potential investors or deals of interest.

In our experience, many of these agreements reward the financial adviser on a success fee basis, usually by reference to a percentage of the total transaction amount in the event that a transaction is completed. Sometimes these agreements also contain what is commonly referred to as a "tail-gunner clause" (TGC), which is intended to protect the financial adviser in the event that the transaction takes place after the agreement is terminated.

When a dispute arises, much will come down to the actual wording of the agreement. The recent Hong Kong Court of Final Appeal (CFA) judgment in *Eminent Investments (Asia Pacific) Ltd v DIO Corporation [2010] HKCFA 38* provides helpful guidance as to how the court will likely approach these type of claims by financial advisers.

The CFA found that mere introduction by the financial adviser is not enough; the financial adviser also has to put in work toward achieving the successful completion of the actual transaction before it is entitled to an introduction fee.

Eminent's claim

In mid-2008, DIO engaged Eminent as financial adviser to explore ways of raising additional capital and expansion. A financial advisory agreement (FAA) was signed that was later supplemented by an addendum. Specifically, the FAA contained a so-called "tail gunner" clause, which provided that DIO would pay Eminent a transaction fee if completion of a transaction took place within two years from the termination of the FAA.

In April 2009, Eminent introduced Dentsply to DIO via a telephone conference, though the discussions were described by the trial judge as "very general" with no particular deals or fundraising transactions being discussed. By mid-to-late April 2009, Dentsply indicated that it was no longer interested in DIO. Subsequently, it appeared that the FAA was terminated (according to Eminent on or about 29 January 2010), but in any event Eminent ceased business by March 2010.

Further discussions between DIO and Dentsply took place and eventually a deal was announced on 9 December 2010 whereby Dentsply acquired the outstanding shares in DIO and its German subsidiary acquired KRW56.6 billion worth of convertible bonds issued by DIO. Eminent then sued for its advisory fee under the FAA and the addendum.

Approach to contractual interpretation

The main argument before the CFA concerned the proper construction of the relevant clauses from the FAA and the addendum regarding entitlement to a transaction fee during the currency and after termination of the agreement.

In reviewing Eminent's grounds for appeal, the CFA reiterated the general approach to contractual interpretation that "the starting point is the ordinary and natural meaning of the words of the contract," though in some cases it is necessary to consider the context. The CFA then reviewed the FAA as a whole and the wording of the individual clauses in detail.

In respect of the entitlement to a fee during the currency of the agreement, the CFA found that the relevant clause (clause 2 iv of the FAA) makes a "completed transaction" pivotal for entitlement to a transaction fee. After examining the wording of the clause in detail, the CFA concluded in summary that "to earn a Transaction Fee, Eminent is required not merely to introduce the third party concerned, but to put in work towards achieving the successful completion of the actual fundraising transaction."

In respect of the entitlement to a fee after termination of the FAA, the CFA found that the words "introduced by the Financial Advisor" qualify "a transaction including and not limited to..." in the tail gunner clause (clause 3 of the FAA) such that "[i]t is the transaction which is successfully completed that Eminent has to introduce." The CFA further stated that "if Eminent introduces the third party but then plays no part or an insignificant part in bringing about the fundraising transaction eventually completed, there is no entitlement to a Transaction Fee."

Tail gunner clauses

The CFA noted expressly that "[w]here parties agree to a "tail gunner clause," they inevitably run the risk of creating grey areas which may give rise to controversy." For example:

1. The financial adviser may have gone beyond merely introducing the client to the potential investor and done a significant amount of work in promoting the deal, which was eventually completed after termination of the FAA but within the runoff period.
2. The client (or a replacement financial adviser) might have taken up the running and made substantial contributions essential to achieving that completion.

Therefore, it may be arguable whether, on particular facts, the financial adviser has done enough to earn the fee.

Implications

The judgment provides useful guidance as to how the Hong Kong courts will likely approach success fee claims made by financial advisers. While every case is different and much of it comes down to the facts of the case and contractual interpretation, the judgment is no doubt an authoritative precedent in determining claims of financial advisers.

As regards tail gunner clauses, notwithstanding that the CFA did not have to consider whether Eminent had "done enough" to earn a fee under the FAA (as it concluded that Eminent did not introduce or contribute anything to the actual transaction), the CFA's general comments suggest

that many tail gunner clauses lack sufficient detail as to what the "proper criterion" is for the financial adviser to earn a fee.

While it is recommended that the drafting of a tail gunner clause should explicitly deal with the question, if a grey area does arise, the CFA indicated that "a possible approach might be to construe the contract as recognising an entitlement to a success fee where the financial advisor's advice and assistance is found to be an "effective cause" of the transaction's completion."

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